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C O N F I D E N T I A L SECTION 01 OF 02 MANAMA 000280

SIPDIS

STATE FOR NEA/ARPI DBERNS
STATE PLEASE PASS USTR JBUNTIN
COMMERCE FOR ITA/MAC/ONE CLOUSTAUNAU AND THOFFMAN

E.O. 12958: DECL: 02/26/2015
TAGS: ECON EFIN EPET ENRG MARR PREL BA
SUBJECT: BAHRAIN FACES BUDGET CRUNCH FOLLOWING SAUDI OIL
GRANT CUTBACK

REF: MANAMA 0064

Classified By: AMBASSADOR WILLIAM T. MONROE
REASONS 1.4 (B) AND (D).

¶1. (C) Summary. Although often lumped together with its richer GCC neighbors, Bahrain is in fact a modest oil producer and is now facing an unexpected budget crunch - despite continuing high international oil prices. Robust spending on much-needed capital projects (deferred when oil prices were low) combined with a 50,000 barrel per day (bpd) cut in Saudi oil aid, resulted in a debt of $1.57 billion, or 16 percent of GDP, in 2004. 2005 looks no better. To compensate, the government has reportedly approached Kuwait for an increase in grant aid and a hefty loan, and has reportedly also approached the UAE government. GOB officials continue to hope that Saudi Arabia will restore the 50,000 bpd grant, and are counting on the U.S.-Bahrain FTA to boost the economy in the short- to medium-term. End Summary.

State of the Budget

¶2. (C) The GOB establishes its budget biannually. Despite expectations that the 2005-2006 budget would be ready January 2005, the GOB has yet to release it. Apparently the GOB is having a difficult time balancing the budget due to the decision by Saudi Arabia to end its 50,000 bpd oil grant in mid-2004 (reftel). This resulted in a 20 percent cut in oil revenues, or 14.6 percent of total government revenues, and is affecting the 2005-2006 budget. In the past, oil revenues accounted for some 73 percent of government revenue, based on 40,000 bpd of domestic production, 150,000 bpd from the jointly held Bahrain-Saudi Arabia Abu Sa'afa oil field, and a 50,000 bpd grant from the Saudis.

¶3. (C) Based on an estimated $41 per barrel of oil, Bahrain's government revenue for 2004 was roughly $4.37 billion. A 14.6 percent loss in government revenues, due to the cut in the Saudi oil grant, is estimated at $638 million. Although per capita GDP is relatively high ($16,900 in purchasing power parity terms per the CIA World Factbook) and the infrastructure is modern, a loss of $638 million was a major shock for the relatively small Bahrain economy, roughly equivalent to the value of new projects proposed during the last budget cycle.

¶4. (C) The Kuwaiti Ambassador to Bahrain told the Ambassador February 28 that the GOB recently requested a $700 million loan from Kuwait to cover the budget deficit, and he thought Kuwait will most likely offer a loan in the $300-350 million range. The Kuwaiti Ambassador also noted Kuwait provides $50 million in budgetary support annually, a figure that may increase to $75 million, as well as $15 million to fund projects, mostly construction of schools. We understand that a major focus of the King's and Prime Minister's recent trip to the UAE was financial assistance.

¶5. (C) Despite the generosity of its neighbors, Bahrain's high government recurrent expenditures (roughly 70-80 percent of the total budget) coupled with the loss of the oil grant will lead to greater accumulation of domestic debt, which accounted for an estimated 16 percent of the GDP in 2004 ($1.57 billion), a figure the IMF considers manageable. Any past budget windfalls due to high oil prices have been used to retire debt or maintain major infrastructure projects.

Comment

¶6. (C) Bahrain's small economy is highly dependent on its supply of oil from Saudi Arabia and the revenues this generates. Although it seems small, the shock of losing the 50,000 bpd Saudi oil grant has caused budgetary strain, limiting the country's flexibility on supporting non-essential programs. In a public statement, Speaker of the Council of Representatives Khalifa Al Dhahrani stated a tighter budget may affect government salaries, causing an uproar in parliament and the press. The Bahrain military is

starting to feel the budgetary heat, as the Ministry of Finance has restricted funding for new military purchases. In a conversation with the Ambassador, Bateleco Chairman Hassan Ali Juma said despite efforts to diversify, Bahrain is still a single-product economy over-burdened with white elephant projects and a welfare system that it can no longer support. Rumors have surfaced suggesting that the GOB may be considering a national tax to support social service programs. Finance Minister Shaikh Ahmed bin Mohammed Al Khalifa requested the Ambassador's support in promoting the FTA as a best way to boost Bahrain's economy in the short- to medium-term.

MONROE